United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1749

B Pgs

To be argued by

ORIGINAL

In The

United States Court of Appeals

For The Second Circuit

IRVING GORDON,

Appellant,

vs.

ROBERT L. BURR, ELPAC, INC., ARNOLD LORD, and PHILIPS, APPEL & WALDEN, INC., (sued herein as PHILLIPS, APPEL & WALDEN),

Appellees.

On Appeal from the Untied States District Court for the Southern District of New York.

REPLY BRIEF FOR APPELLANT

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INTRODUCTION

This brief is submitted by Plaintiff-Appellant in reply to the briefs of Appellees-Defendants, ARNOLD LORD ("LORD"), PHILIPS, APPEL & WALDEN, INC. ("PHILIPS, APPEL & WALDEN") and ELPAC, INC. ("ELPAC"). The principal issue presented to the court in this appeal, is whether plaintiff must prove common law damages in an action for rescission in order to entitle him to restitution against joint tort feasors who are not in privity of contract with him.

STATEMENT OF FACTS

Inasmuch as the court has already received four recitations of facts in the briefs of Appellant and the three Appellees, plaintiff will not for a fifth time rehash the matter for the courts. However before proceeding to a discussion of the principal legal issues of the case, plaintiff will draw the Court's attention to certain aspects of the Appellee's recitations of facts which underscore the weakness of their position in this appeal.

Emphasis by Lord and Philips, Appel & Walden on their "Lack of Compensation".

In their recitations of fact, both LORD and PHILIPS, APPEL & WALDEN harp on the point that LORD claimed to be uncompensated for his brokerage services on behalf of BURR and ELPAC. (LORD's brief, page 6; PHILIPS, APPEL & WALDEN's brief, page 6). Of course they do not deny that LORD was in fact the broker for the transaction or that he was at the time a registered representative of PHILIPS, APPEL & WALDEN. Nor do they gainsay the undeniable fact that when LORD filled in the "Statement of Transferee" required by the State of California, LORD completed the form as follows:

> "I have received advice from the following professional adviser or advisers in connection with my proposed investment in ELPAC, INC.: (state "none" if none).
>
> Arnold A. Lord
>
> PA&W 469 7 Ave. NYC
>
> 10018

(38a, 168a-169a, 341a)

Defendants would have us believe that the exertions by LORD at the very time he was a registered representative of PHILIPS, APPEL & WALDEN, on behalf of BURR and ELPAC were some sort of charitable endeavor undertaken on LORD's free time - pro bono publico.

An examination of the record, however, suggests that defendants protestation of financial disinterest in the affairs of BURR and ELPAC are a bit strained. In May, 1968, PHILIPS, APPEL & WALDEN participated in a private placement of ELPAC stock and although it did not receive a commission, they did receive a continuing right of first refusal on further offerings of ELPAC stock (267a - 271a). After the transaction which is the subject of the complaint, PHILIPS, APPEL & WALDEN and their registered representative LORD, participated in another transaction involving the raising of funds for ELPAC. This transaction which involved a merger with a company called Aero Science & Electronics, resulted in a substantial commission being paid to PHILIPS, APPEL & WALDEN, and LORD (272a - 275a).

Moreover, LORD, after first denying he had ever received more than a thousand dollars from Mr. Burr, President of

ELPAC (294a, 295a, 296a), suddenly remembered, after his memory had been refreshed by plaintiff's counsel, receiving over three thousand dollars from BURR less than three months after the transaction alleged in the complaint, supposedly in connection with another deal (297a).

So much for pro bono publico.

The Alleged "Two and One Half Year Delay"

Both LORD and PHILIPS, APPEL & WALDEN in their briefs, in an apparent attempt to lay ground work for their contention that plaintiff is estopped from claiming rescission because of delay make reference to a "two and one half year delay" from the time plaintiff paid for the stock until the time the action herein was commenced (LORD's brief, page 6; PHILIPS, APPEL & WALDEN's brief, page 7). What they conveniently overlook is the fact that although plaintiff paid for the stock in August, 1968, he did not receive the stock or discover the fraud perpetrated on him until March, 1969 and thereafter promptly sought to rescind the transaction (see discussion in Court's Opinion, 43a, 44a, 45a).

Particularly inappropriate is the insinuation on page 6 of LORD's brief that plaintiff delayed seeking relief for two and one half years until "after the market price began to fall." (Emphasis supplied). The facts as set forth in the Court's Opinion above do not jive with that contention.

Extravagent Hyperbole of Philips, Appel & Walden

Although one attribute of a well prepared brief may be an aggressive presentation of the facts, the suggestion on page 7 of the PHILIPS, APPEL & WALDEN brief that plaintiff "recanted" a part of his testimony is a rather supercilious use of a rather serious word suggesting, as it does, that plaintiff retracted some perjurous statement.

The testimony that plaintiff is supposed to have "recanted in part" was the sworn testimony of the plaintiff that he called the offices of PHILIPS, APPEL & WALDEN on at least two occasions, one in late 1968 and the other in 1969 and when he inquired as to LORD's whereabouts, he was only asked to leave his name and number so that LORD could

call him back. It is PHILIPS, APPEL & WALDEN's contention that at the time of those calls LORD was no longer a registered representative of the company.

This is indeed damaging testimony to PHILIPS, APPEL & WALDEN for they had gone to great lengths to draw a line between themselves and LORD. The failure of PHILIPS, APPEL & WALDEN to inform plaintiff that LORD had left the company and the apparent providing of a cover for his activities after he allegedly left the company puts them cheek by jowl with LORD in his involvement with this case. Anderson v. Francis I. DuPont & Co. 291 F. Supp. 705 (D. Minn. 1968).

However, nowhere in the record is this testimony discredited. In its brief, PHILIPS, APPEL & WALDEN cites pages 160a - 161a and 171a - 172a of the Appendix as evidence that plaintiff had "recanted in part" his testimony (PHILIPS, APPEL & WALDEN's brief, page 7). Appellant submits that nowhere in those cited pages does plaintiff recant a single word of his testimony. His statements that he called PHILIPS, APPEL & WALDEN, asked for LORD and was not informed that LORD was no longer there, stand unchallenged. He has

not "recanted" in whole or in part. Neither has his testimony been retracted, abjured, disavowed, abrogated, or contradicted.

POINT I

APPELLEE-DEFENDANTS HAVE MISREAD THE PRINCIPAL AUTHORITIES IN POINT.

The principal issue of this appeal is whether a court whose equity jurisdiction has been invoked may order restitution from a joint tort feasor not in privity of contract with the plaintiff. Plaintiff contends that it may. Defendants seem to maintain that the court of equity may only award common law damages and does not have the power to order restitution from joint tort feasors.

In his brief plaintiff has stressed two cases which are clearly in point in this matter. Mack v. Latta, 178 N.Y. 525 (1904) and John Hopkins University v. Hutton, 343 F.Supp. 245 (D. Md. 1972) reversed on other grounds, 488 F.2d 1912 (4th Cir. 1973), cert. den., 94 S.Ct. 1623 (1974). The Mack case has been cited with approbation by the United States Supreme Court in the case of McCandless v. Furland, 296 U.S. 140, 165. It is a clear holding that restitution may be ordered from participants in a securities fraud even though they were not in privity of contract with the defrauded purchaser.

The Mack Case

Appellant PHILIPS, APPEL & WALDEN in its discussion of Mack ignores the authorization for ordering restitution and cites it as holding only that a court may entertain in a single action an equitable claim and a common law damage claim. In its brief, page 15, PHILIPS, APPEL & WALDEN says:

> "The Court further held that in order to avoid a multiplicity of actions, the Court, sitting as a court of equity, could exercise its concurrent jurisdiction in an action at law based on fraud against officers and agents of the corporation."

This is errant nonsense. Nowhere in its opinion does the Court of Appeals in the Mack case state that it is authorizing an award of common law damages, rather the court says quite clearly that it is ordering a return of monies paid out of pocket by the plaintiff in order to make it whole and it is doing so as a court of equity.

Thus at 178 N.Y. 527, the court describes the plaintiff as seeking "to have judgment against the individual defendants, as well as against the corporation, for the $100,000 paid, with interest." At 178 N.Y. 531, the court quotes favorably from Cook on Corporations the following language:

> "A court of equity in these actions will give complete relief by decreeing that the directors guilty of the fraud shall refund to the subscriber payments made by him before discovering the fraud. The relief dispenses with an action at law for damages for deceit, and when sought for in the bill of equity the guilty directors must be made parties."

On the same page, the court cites Thompson on Corporations and quotes the following language:

> "...the courts of equity exercising jurisdiction concurrent with that of courts of law. Hence the fact that a person defrauded in this manner has a remedy at law, does not oust the jurisdiction to afford him relief."

The contention of the defendants is that the relief sought against the directors in the Mack case was a cause of action at law. Clearly, the court found that there was only one action in equity.

The error of defendant LORD is even more egregious. On page 10 of its brief, LORD describes Mack as holding that:

> "...in order to prevent a multiplicity of suits, plaintiff may combine an equitable rescission and restitution action against one defendant with a legal, damage action against another defendant, upon a showing of probable unenforceability of the equitable remedy." (Underscoring added)

Plaintiff is at a loss to understand this statement of the Mack case. NOWHERE in the Mack opinion, nowhere at all,

is there any statement that there must be, as defendants maintain, a showing of a probable unenforceability of the equitable remedy. The only language of the opinion, even remotely resembling the supposed rule of the case is that found on page 529 of 178 N. Y. where the court speculates on the result of separate suits:

> "So if plaintiff had brought his action against the corporation alone and obtained a judgment cancelling the contract and awarding him the $100,000 advance, and he should have failed to collect from the corporation by reason of its lack of assets, he could undoubtedly have collected the balance in an action at law against the officers whose fraudulent representations had induced the contract."

But this is clearly only the supposition of the court as to what might result from multiple suits. The opinion goes on to say:

> "That being so, it is clear that a multiplicity of actions would be avoided, and a greater certainty of collection would result in an action such as this, where all the parties being before the court - those guilty of fraud as well as the direct beneficiary of the fraud - the court could enjoin actions by the corporation for the balance of the subscription, cancel the subscription, and give judgment against all of the defendants for the amount paid, directing collection so far as possible out of the corporation, the balance, if any, to be collected from the individual defendants." 178 N. Y. 530 (Emphasis supplied)

The court, by using the phrase, "the balance, if any", recognizes that the corporation itself may be able to pay the judgment. It is certainly not requiring any showing, or even allegation of probable inability to pay as defendants maintain. Plaintiff will not belabor the point. Both defendant LORD and defendant PHILIPS, APPEL & WALDEN have obviously misread the Mack case for their own purposes.

The John Hopkins Case

The discussion of the case of John Hopkins University v. Hutton, supra found on page 16 of defendant PHILIPS, APPEL & WALDEN's brief, is similarly confused.

First, PHILIPS, APPEL & WALDEN states that "Hopkins purchased certain oil and gas interests from Hutton acting as seller's agent and as underwriter of the securities being purchased" (PHILIPS, APPEL & WALDEN's brief, page 16). As a matter of fact, Hopkins purchased the securities directly from Trice, the seller, at a closing not even attended by Hutton or any of its representatives and remitted the full purchase price to Trice. John Hopkins University v. Hutton, 297, F. Supp. 1165 at 1172, 1173, 1175, 1191, 1192, 1209 (D. Md. 1968).

Next, PHILIPS, APPEL & WALDEN states that "The only extensive discussion of rescission was in the first reported decision in the action." (PHILIPS, APPEL, & WALDEN's brief, page 17). Errant nonsense again. The last reported series of decisions in the case cited on page 16 of the PHILIPS, APPEL & WALDEN brief dealt with the right of Hopkins to rescission under 10b. 5 and explicitly contemplated an order of rescission in restitution against Hutton.

Finally, on page 18 of the PHILIPS, APPEL & WALDEN brief, it is stated that:

> "The availability of the remedy of rescission against Hutton was never an issue in the case because it was clearly in privity with both the seller and the purchaser. That is not the situation here with respect to PHILIPS, APPEL & WALDEN, which was not acting as anyone's agent and which received no commissions or benefit of any kind from the transaction."

Pro bono publico again. As noted above in this brief, PHILIPS, APPEL & WALDEN, and LORD, both had a long standing relationship with ELPAC, the issuer of the stock in question. Moreover, once again PHILIPS, APPEL & WALDEN has misread, or deliberately dodged, the point of the Hutton case. LORD, (PHILIPS, APPEL & WALDEN's registered

representative), certainly functioned as a broker in this case, even if PHILIPS, APPEL & WALDEN did not. Certainly vis-a-vis Hopkins. The trial court found that PHILIPS, APPEL & WALDEN was in fact responsible for LORD's actions and therefore PHILIPS, APPEL & WALDEN is liable just as LORD is liable.

For obvious reasons, LORD did not dwell at any point in his brief on the clear meaning of the Hopkins case.

POINT II

RESTORATION OF THE STATUS QUO IS THE ONLY EQUITABLE REMEDY WHEN RESCISSION IS ORDERED.

Defendants cases discussing the appropriate measure of damages in actions at law for damages have no application.

Point I of plaintiff's brief notes the complete arsenal of what equitable relief is available to individuals damaged by securities frauds. However, defendants insist on burdening the courts with a plethora of cases discovering common law measures of damages. These cases have no application in an action for rescission for one simple reason:

> In an action for rescission the plaintiff gives back what he has received, thus the value of the property is not relevant to the question of restitution.

The logic of this approach is demonstrated by one case cited by defendant PHILIPS, APPEL & WALDEN in its brief, Smith v. Bolles, 132 U.S. 125. The Supreme Court, in discussing the common law rule of damages described in an applicable precedent said at page 130 of its opinion:

> "In that case...the defendant was held responsible for monies put into the scheme by the plaintiff in the ordinary course of business, which were monies lost less the value of the interest which plaintiff retained in the property held by those associated in the speculation." (Emphasis supplied)

The key to unlocking our dispute is the phrase "The value of the interest retained." Normally in an action at law something has been retained. In an action seeking rescission, nothing will be retained. As a part of the decree plaintiff will be directed to transfer the subject of the action to the defendant. Thus, in considering restitution we do not take into account the value of the property concerned. To apply the common law measure of damages to an equitable action is to indulge in a legal fiction and ordain unequal recoveries from equally culpable parties.

Equity regards as done what ought to be done. Once rescission has been decreed, the value of the stock is no longer relevant in determining the amount of monetary recovery since the plaintiff will not retain the stock.

Plaintiff would briefly comment further on the attempt of the defendants to cast doubt on the validity of the precedent of Mack v. Latta by citation of a number of lower court cases, notably Jacoby v. Duncan, 138 Misc. 777, 247 N.Y.S. 318 (Sup. N.Y. 1931) and Alexander City Bank v. Equitable Trust Co., 223 App. Div. 24, 227 N.Y.S. 403 (1st Dept. 1928). The equation of a trial court case (Jacoby) and a first department

case (Alexander) with a New York Federal Court of Appeals case is not appropriate. Moreover, the Alexander case has been overruled by clear implication in the First Department case of Inman v. Credit Discount Corporation of America, et. al., 230 App. Div. 505 (1st Dept. 1930). In the Inman case, the complaint set forth a single cause of action seeking rescission and restitution of monies paid for stock. The court, citing Mack v. Latta, supra, specifically held that active participants in the fraud were proper parties defendant with the issuer of the stock. The dissenting judge, cited the Alexander case as an argument that only those who receive the benefits of the contract were proper parties. This contention was specifically rejected in the majority opinion.

The Alexander case was also not followed in the First Department case of Kaufman v. Jaffee, 244 App. Div. 344 (1st Dept. 1935). In that case, the court specifically held that in a suit based upon a rescinded contract the value of the property received was irrelevant to the amount of the recovery.

POINT III

THE FINDINGS THAT BOTH LORD, AND PHILIPS, APPEL & WALDEN WERE RESPONSIBLE FOR VIOLATIONS OF THE SECURITIES EXCHANGE ACT WAS NOT CLEARLY ERRONEOUS.

The findings of fact of the trial court must stand unless clearly erroneous. Rule 52(a) F.R.C.P. It is submitted that there is ample justification for the court's determination that BURR and LORD made deliberate misrepresentations of fact to the plaintiff and that the misrepresentation made was material. Affiliated Ute Citizens of Utah v. U.S. 406 U.S. 128 (1972). Responsibility of PHILIPS, APPEL & WALDEN was establihsed not only under Section 20(a) of the Securities Exchange Act, but also as an aider and abettor. Anderson v. Francis I. DuPont & Co., supra.

As to the question of the diligence of plaintiff in seeking rescission, he would merely refer the court to that portion of the judge's opinion dealing with this question which was cited above.

As to defendant ELPAC, reference is made to Point V of plaintiff's main brief.

CONCLUSION

Inasmuch as a bill of rescission may decree restitution against culpable parties not in privity of contract, the trial court erred in dismissing Appellant's claim for failure to state a claim against LORD, and PHILIP, APPEL & WALDEN. Although the trial court expressed certitude as to the correctness of its dismissal, the large body of law on Appellant's behalf justified Appellant's course of action in believing rescission did lie against LORD, and PHILIPS, APPEL & WALDEN. In the interest of justice, a new trial as to damages should be ordered since the exoneration of parties culpable under the Securities Exchange Act is contrary to congressional policy.

Finally, even if a new trial is not proper at this point, the dismissal against LORD, and PHILIPS, APPEL & WALDEN, with prejudice, is improper since damages are inchoate and the door should be opened for Appellant to bring a new action should restitution from BURR fail.

Respectfully submitted,

LEONARD LOEWINTHAN
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Of Counsel:
JOHN C. KLOTZ

A 201 Affidavit of Service by Mail — LUTZ APPELLATE PRINTERS, INC.

UNITED STATES COURT OF APPEALS:SECOND CIRCUIT

GORDON,

Appellant,

against

BURR,

Appellees.

Index No.

Affidavit of Service by Mail

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Karen Giles, being duly sworn,

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

1013 East 180th Street, Bronx, New York

That upon the 5th day of September 1974, deponent served the annexed Reply Brief

upon * attorney(s) for

* in this action, at *

the address designated by said attorney(s) for that purpose by depositing a true copy of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.

Sworn to before me, this 5th day of September, 1974

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 34 - 0413950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975

Robert T. Brin

Karen Giles

Print name beneath signature

KAREN GILES

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